

**AGENDA ITEM 5
AUDIT RESOLUTION STATUS
FINANCIAL STATEMENT AUDIT MANAGEMENT LETTER COMMENTS – CURRENT YEAR
AS OF DECEMBER 31, 2008**

Auditor Audit Scope/ (Report Issue Date)	Responsible Division(s)	Finding Number and Description	Management's Response
Macias, Gini & O'Connell Report to Management for the Year Ended 06/30/08 (2/18/09)	Fiscal Services	<p>1. GAAP Accounting for Service Credit Purchases We recommend Fiscal Services properly record service credit purchases under installment agreements in accordance with GAAP. Contributions should be recognized at the time the installment agreement is executed, rather than deferred until payment is received. Fiscal Services should also analyze prior repayment patterns and estimate an allowance for doubtful accounts to record receivables at their net realizable value.</p> <p>2. Reconciliation of Real Estate Financial Data The Real Estate Investment Unit within Fiscal Services does not reconcile the partners' audited financial statements to CalPERS' general ledger or the partners' monthly or quarterly financial statements, which increases the risk that adjustments made during the partnership audit are not properly reflected in the general ledger. We recommend that management establish a formal policy requiring the reconciliation of the partnerships' audited financial statements with CalPERS' general ledger. Furthermore, management should implement a formal process to monitor the receipt of audited financial statements and ensure partners comply with contract provisions.</p>	<p>CONCUR. Fiscal Services will review and implement procedures to recognize service credit purchase contributions in accordance with GAAP. Fiscal Services will work with the Member Services Division to analyze prior repayment patterns and record a fiscal year end entry to estimate an allowance for doubtful accounts to state these receivables at their net realizable value.</p> <p>CONCUR. Fiscal Services will work with the Investment Office to establish a formal policy requiring the reconciliation of the partnerships' audited financial statements with CalPERS' general ledger or partnerships' monthly or quarterly financial statements. Fiscal Services will also implement a reconciliation process that will compare the audited financial statements with the monthly or quarterly financial statements reported by the real estate partners for the same period using the new automated real estate investment system (AREIS). Any discrepancies noted will be brought to the attention of the Investment Office and the real estate partners for explanation or adjustment.</p>

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Macias, Gini & O'Connell Report to Management for the Year Ended 06/30/08 (2/18/09) (continued)	Fiscal Services	<p>3. Prompt Resolution of Reconciling Items We identified 2 reconciling items in the Investment Accounting Master Reconciliation, totaling approximately \$26.9 million, that had been carried forward from several prior years, and had not been investigated and resolved in a timely manner. Timely resolution of reconciling items is an essential part of the accounting function. We recommend that Fiscal Services investigate and resolve all discrepancies as part of the reconciliation process. Reconciling items should not be carried forward to future periods unless they represent legitimate timing differences.</p> <p>4. Analysis and Reconciliation of Accounts In performing our audit procedures, we discovered several errors in the Deferred Compensation Fund (DCF), as Fiscal Services had not reconciled year-end account balances. Management recorded several audit adjustments to correct revenues, expenses and liabilities as a result of our procedures. We recommend that Fiscal Services develop a formal policy that requires a periodic analysis and reconciliation of DCF account balances.</p>	<p>CONCUR. The two outstanding reconciling items on the June 2008 Master Reconciliation from fiscal year 2004 for performance and management fees have been investigated and resolved as of December 2008. Fiscal Services will enhance our Master Reconciliation processes and procedures to clear reconciling items timely.</p> <p>CONCUR. Fiscal Services will develop a formal policy that requires a periodic analysis and reconciliation of DCF account balances. Fiscal Services will also review and enhance the current general ledger account structure in the DCF. These improvements will mitigate miscoding of revenue, expenses and liabilities, and increase management oversight of more timely account balance reconciliations.</p>

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Macias, Gini & O'Connell Report to Management for the Year Ended 06/30/08 (2/18/09) (continued)	Fiscal Services	<p>5. Manual Accounting for Supplemental Contributions Although the third party administrator maintains records of individual participant accounts, the custodian bank does not account for the investments of the Supplemental Contributions Program and IRC 457 in separate portfolios. As a result, for financial statement purposes, Fiscal Services manually allocated the investment balances and the related amounts within a portfolio which contains holdings of both funds reported by the custodian bank. The manual allocation increases the risk that investment-related activities will be misstated in the financial statements.</p> <p>6. Analysis and Reconciliation – GASB 40 and AIM Our audit procedures revealed numerous errors and inconsistencies in the GASB 40 disclosures, as Fiscal Services did not independently verify whether the amounts provided by the custodian bank were accurate or in conformity with the provisions of GASB Statement No. 40. The original data provided by the custodian bank had a variance of approximately \$6 billion which was subsequently addressed and the appropriate data was included in the CalPERS financial statements.</p> <p>We also discovered errors in the financial statement disclosure of unfunded alternative investment commitments. Certain amounts provided by CalPERS' third party service provider did not agree to information provided by the partners. Although the disclosed amounts were corrected, Fiscal Services did not independently corroborate the unfunded commitments in preparing the financial statement disclosure.</p>	<p>CONCUR. The multi-class structure of Supplemental Income Plan (SIP) portfolios established by the custodian bank does not accommodate separate investment portfolios for each plan (IRC-457 and SCP). Fiscal Services will work with the custodian bank to provide CalPERS with customized reporting that will eliminate the manual calculation processes and segregate financial data such as investment balances and related investment receivables, payables, gains and losses by plan.</p> <p>CONCUR. Fiscal Services concurs with the recommendation. Fiscal Services will reconcile GASB Statement No. 40 investment data to the general ledger and will follow up on any discrepancies with the custodian bank. Fiscal Services will also develop and perform procedures to ensure the conformity of the related disclosures with GAAP reporting requirements.</p> <p>Fiscal Services implemented a quarterly reconciliation process in fiscal year 2008-09 to compare the unfunded amounts reported by the general partner with those reported by PrivateEdge, third party service provider. The reconciliation will be reviewed to determine that the amounts are complete and calculated correctly and any discrepancies noted are brought to the attention of PrivateEdge for explanation or correction.</p>

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Macias, Gini & O'Connell Report to Management for the Year Ended 06/30/08 (2/18/09) (continued)	Fiscal Services	<p>7. Journal Entries Posted After Trial Balance Date Subsequent to providing the independent auditor with the June 30, 2008 trial balances, Fiscal Services recorded approximately 60 journal entries, which changed the account balances and transaction totals in numerous funds. The significant number of journal entries resulted from untimely reconciliations, closing procedures, and receipt of third-party data. The significant number of journal entries created considerable inefficiencies in the audit process, which resulted in added costs for CalPERS.</p> <p>Trial balances provided to the auditor should reflect all accruals, adjustments and closing journal entries other than certain known adjustments which are dependent upon information provided by third parties.</p> <p>8. Complete Disclosure of Contingent Losses We identified a contingent loss that was not properly disclosed in the draft financial statements. Current procedures are not sufficient to ensure that contingencies will be accrued or disclosed in accordance with GAAP.</p> <p>We recommend that Fiscal Services meet with CalPERS' general counsel to identify pending litigation, claims and assessments in conjunction with the preparation of the annual financial statements and ensure all legal responses are included in the financial statements when appropriate.</p>	<p>CONCUR. Fiscal Services concurs with the recommendation. Fiscal Services will assess its resources, existing workload, and current procedures in order to develop a reasonable timeline for closing the books and preparing the trial balances. Fiscal Services will incorporate procedures to ensure reconciliations are completed timely to ensure the trial balances provided to the external auditors will reflect all accruals, adjustments, and closing journal entries other than certain adjustments for real estate and private equity investments which are dependent upon third party information.</p> <p>CONCUR. Fiscal Services will coordinate efforts with CalPERS' General Counsel to develop a process where Fiscal Services will be notified of pending litigation, claims and assessments in conjunction with the preparation of the annual financial statements. In addition, Fiscal Services will review the responses to the auditor's inquiries provided by CalPERS' Legal Office as well as outside attorneys and determine whether there are material items which must be accrued or disclosed in the financial statements.</p>

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Macias, Gini & O'Connell Report to Management for the Year Ended 06/30/08 (2/18/09) (continued)	Fiscal Services	<p>9. Management's Discussion and Analysis Improvements Management's discussion and analysis prepared by Fiscal Services meets the minimum GAAP requirements; however, we believe incorporating the unique perspectives of the managers responsible for key activities would enhance the usefulness and improve the users' understanding of the financial statements.</p> <p>We recommend that Fiscal Services obtain narrative explanations of the significant changes in financial position and results of operation from management responsible for the related activities. Fiscal Services should be heavily involved in the analysis to ensure compliance with the financial reporting standards and to avoid redundancy in the MD&A.</p>	CONCUR. Fiscal Services concurs with the recommendation. Fiscal Services will lead the CalPERS Financial Reporting Committee to meet these objectives. As the coordinator and facilitator for the Committee, Fiscal Services will add this observation. Key program divisions will provide the narrative for developing explanations of significant changes in financial position and results of operations.
	Actuarial Office	<p>10. Spreadsheet Controls to Protect Data Currently, a spreadsheet designed by the Actuarial and Employer Services Branch is used to calculate Replacement Benefits Fund benefits. The spreadsheet is not password protected.</p> <p>The Actuarial and Employer Services Branch should establish protection of the spreadsheet such as password, cell protection, and limits to access. In addition, management should establish a formal policy requiring an independent review of the calculations.</p>	CONCUR. The Actuarial Office will work with the Benefit Services Division (BNSD) to implement a password protected spreadsheet in the 2009 calendar year. Certain formula or cell values within the worksheet will be protected to prevent unauthorized modification. In addition, a formal policy will be developed by BNSD to ensure the calculations, notification letters and invoices are regularly reviewed.

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Macias, Gini & O'Connell Report to Management for the Year Ended 06/30/08 (2/18/09) (continued)	Fiscal Services	<p>11. Independent Verification of External Fees Administrative and investment management fees for the IRC 457 fund, State Peace Officers' and Firefighters fund (SPOFF) and the Supplemental Contributions Program fund (SCPF) are calculated by the custodian bank, and are not independently validated by Fiscal Services. In addition, we noted a delay in receiving invoices from third parties which meant the fourth quarter invoices recorded in the CalPERS financial statements were based on estimates.</p>	<p>CONCUR. Fiscal Services concurs with the recommendation. Fiscal Services will implement procedures to verify fees calculated by the custodian bank prior to posting to the general ledger. Fiscal Services will also work with the Investment Office to ensure these invoices are received as soon as possible and independently verify fees presented on invoices received from third parties prior to payment.</p>
	Actuarial Office	<p>12. Actuarial Assumption – Judges Retirement Fund The June 30, 2007 actuarial valuation for the Judges Retirement Fund (JRF) assumes a 7 percent investment rate of return in calculating the plan liabilities and the State's annual required contributions. However, since the State has a pattern of funding benefits as they become due, the JRF has not accumulated significant long-term investments for the payment of future benefits. We recommend that CalPERS Actuarial Office consider whether the current 7 percent rate of return assumption is appropriate for financial reporting purposes, given the short-term nature of JRF assets. The Actuarial Office should consider whether a lower interest rate, consistent with the expected yield of the State's short-term investments, would be more appropriate.</p>	<p>CONCUR. Beginning with the June 30, 2008 actuarial valuation, CalPERS Actuarial Office will disclose financial reporting numbers based on a lower interest rate, consistent with the expected yield of the State's short-term investments. To ensure consistency, the interest rate selected should be the same as the interest rate used for the pay-as-you go scenario in the OPEB actuarial valuation report issued by the State Controller's Office covering the same fiscal year as the fiscal year of the ARC for JRF. However, CalPERS will continue to provide in its actuarial valuation report figures using the 7 percent investment rate in the event the State decided to start pre-funding benefits.</p>

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Macias, Gini & O'Connell Report to Management for the Year Ended 06/30/08 (2/18/09) <i>(continued)</i>	Information Technology Services Branch	13. Password Requirement Non-Compliance We found that password requirements used to access the mainframe applications, RIBS and CRS, currently do not fully adhere to CalPERS' Information Security Identity Authentication Practice certain key areas. We recommend CalPERS' mainframe administrator update the Resource Access Control Facility (RACF) security settings to ensure that the settings comply with the Information Security Identity Authentication Practice. The Information Security Office should conduct periodic monitoring to ensure compliance.	CONCUR. The Enterprise Mainframe Service Support Team (the Team) agrees with the finding and recommendation. The mainframe RACF administrators and Enterprise Mainframe Server Support technical staff will update the RACF security settings to insure that they comply with the ISOF Identity Authentication Practice. The planned target completion date is January 31, 2009.